IN THE

Supreme Court of the United States

OCTOBER TERM, 1951

NOS. [redacted] 57

F. DONALD ARROWSMITH and RUTH R. BAUER, Executors of the Last Will and Testament of Frederick R. Bauer, Deceased and RUTH R. BAUER,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

MARY STEWART VIVIAN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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Cases Cited.

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your Petitioners, F. Donald Arrowsmith and Ruth R. Bauer, Executors of the Estate of Frederick R. Bauer, and Ruth R. Bauer, individually, and Mary Stewart Vivian, hereby respectfully request this Honorable Court to issue

writs of certiorari to the United States Court of Appeals for the Second Circuit to review the decision and judgments of that Court which reversed the decisions of the Tax Court of the United States in these proceedings (R., pp. 18, 21, 23).

The Tax Court, Judge Ernest H. Van Fossan presiding, reversed determinations by the Commissioner of Internal Revenue of deficiencies in the Petitioners' income tax liabilities for the year 1944 (R., pages 7-10).

Opinions Below.

The opinion of the Court of Appeals is reported in 193 Fed. (2d) 734, and appears at pages 18 to 20 of the Record.

The findings of fact and opinion of the Tax Court are reported in 15 T. C. 876, and appear at pages 4 to 9 of the Record.

Jurisdiction.

The opinion of the Court of Appeals was entered on January 10, 1952 (R., pp. 21, 23). A Petition for rehearing was filed on January 24, 1952 (R., p. 25), and was denied without opinion on February 11, 1952 (R., p. 30).

The jurisdiction of this Court is invoked under Section 1254 of Title 28, United States Code.

Question Presented.

Where a judgment against Frederick R. Bauer, individually, and a dissolved corporation in which both he and Mary Stewart Vivian had been stockholders was paid equally by Bauer and Vivian, are their resultant losses capital losses?

Summary Statement of Facts.

The facts were fully stipulated and were found by the Tax Court as stipulated (R., pp. 4-7). They may be summarized as follows:

In April, 1933, a corporation known as Bauer, Pogue & Company, Inc. was organized under the laws of Delaware. One-half of the stock thereof was issued to the taxpayer, Frederick R. Bauer, and one-half to Davenport Pogue. Upon the death of Pogue in 1937, F. Donald Arrowsmith was appointed Executor of his will and decedent's 50% share of the stock was transferred to his estate. Taxpayer, Mary Stewart Vivian, is Pogue's widow, she having remarried some time subsequent to 1940. She acquired all of the one-half interest in said stock formerly belonging to Davenport Pogue, Deceased, as heir of his estate.

On or about December 15, 1937, the corporation began a series of distributions in complete liquidation and made further liquidation distributions in 1938, 1939 and 1940. In compliance with Code Section 115(c) the last of the distributions in complete liquidation was made June 5, 1940, within two years after the end of the corporation's fiscal year ended June 30, 1938, within which fiscal year the first of said liquidating dividends was paid. The corporation paid equal sums in liquidation of each one-half stock interest.

The amounts paid in liquidation of the Bauer shares were all paid to taxpayer Frederick R. Bauer. The amounts paid in liquidation of the Pogue shares were paid as follows: the 1937 and 1938 payments were made to the Estate of Davenport Pogue, Deceased, and the 1939 and 1940 payments were made to taxpayer Mary Stewart Pogue (now Vivian).

The total payments in liquidation of each of said one-half stock interests amounted to $251,069.21. Taxpayer Frederick R. Bauer received said full sum in liquidation of his shares. The taxpayer Vivian received in 1939 and 1940 liquidating dividends upon the Pogue shares totalling $144,149.12.

The liquidating distributions paid to Bauer were reflected in his income tax returns for 1937, 1938, 1939 and 1940 as capital transactions.

As to the liquidating dividends paid on the Pogue shares, no report was made in the income tax return of the Estate of Davenport Pogue, Deceased, for that paid in 1937. The liquidation distribution paid in 1938 was reflected as a capital transaction in the income tax return of the Estate of Davenport Pogue for that year. The liquidation distributions paid in 1939 and 1940 were reflected in the income tax returns of Mary Stewart Pogue (now Vivian) as capital transactions.

On or about June 8, 1939, an action was commenced in the Supreme Court of the State of New York by Adele D. Trounstine, as Ancillary Executrix of the Last Will and Testament of one Norman S. Goldberger, as Plaintiff, against Bauer, Pogue & Company, Inc., Frederick R. Bauer and F. Donald Arrowsmith, as Executor of the Last Will and Testament of Davenport Pogue, as Defendants. The suit was for an accounting as a result of operation of a joint trading account for profit. This proceeding was transferred to the District Court of the United States for the Southern District of New York because of diversity of citizenship. F. Donald Arrowship, as Executor of the Estate of Davenport Pogue, was never served with summons. After trial a judgment was entered in favor of the plaintiff against Bauer, Pogue & Company, Inc. and

against taxpayer Frederick R. Bauer, individually. Bauer, Pogue & Company, Inc. and Bauer appealed, and the plaintiff filed a cross appeal, in the United States Court of Appeals for the Second Circuit, which later affirmed the decision. *Trounstine* v. *Bauer, Pogue & Co., Inc.* 144 F. (2d) 379. The Court of Appeals held that there was no error in holding Bauer personally liable and that he was jointly and severally liable with the corporate defendant.

Bauer, Pogue & Company, Inc. and Bauer applied to the Supreme Court of the United States for writ of certiorari which was denied in 1944. *Bauer, Pogue & Company, Inc.* v. *Trounstine* (1944), 323 U. S. 777.

Thereafter, on December 11, 1944, after the judgment in the above proceeding had become final, each of the taxpayers, Vivian and Bauer, was required to and did pay one-half of the judgment. The net amount of the judgment, after certain credits and adjustments, was $95,926.52 inclusive of interest and costs, and each taxpayer paid one-half or $47,963.25 in satisfaction thereof.

In their respective income tax returns for the calendar year 1944 taxpayers deducted said payments of $47,963.25 as ordinary losses.

The Commissioner determined in each case that the judgment loss of $47,963.25 constituted a capital loss deductible as provided by Section 117 of the Internal Revenue Code.

The Tax Court held that the losses from payment of the judgment constitute ordinary losses for 1944, the year of payment [R., p. 9].

The Court of Appeals reversed the Tax Court and held that the payments should be treated as capital losses [R., pp. 19, 20].

Specifications of Error.

The Court of Appeals erred:

1. In reversing the judgments of the Tax Court.

2. In holding that the losses were diminution of capital gains reported in an earlier year and were therefore capital losses arising from a sale or exchange of a capital asset.

3. In finding a fact not found by the Tax Court, namely, that the losses arose from a sale or exchange of a capital asset.

4. In disregarding the well-established rule of annual accounting for income tax purposes.

5. In holding that Bauer's liability would not have existed except for the capital distributions by the corporation.

6. In holding that because he was also liable as a transferee, Bauer's individual liability to pay the judgment was superfluous.

7. In denying Bauer the privilege of paying his liability as an individual rather than as a transferee.

Reasons for Granting the Writs.

1. The opinion of the Court below specifically disagrees and is in direct conflict with that of the Court of Appeals for the Third Circuit in *Commissioner* v. *Switlik*, 184 Fed. (2d) 299 upon the same question. In that case the taxpayers received a liquidating distribution in 1941

which they reported as long-term capital gain. During 1944 as transferees they paid tax deficiencies assessed against the corporation and reported such payments as ordinary losses deductible in full. The Commissioner characterized the payments as capital losses, deriving their nature from the liquidation in 1941. The Tax Court held that the losses sustained in 1944 were ordinary losses, and the Court of Appeals for the Third Circuit affirmed.

In the present case the Court of Appeals held to the contrary,—that the losses derived their nature from the liquidation in the earlier year, and were therefore capital losses, specifically disagreeing with the Court of Appeals for the Third Circuit.

In the instant case the Tax Court rejected the Commissioner's contention that the *Switlik* case, *supra*, was distinguishable because it involved payment of taxes rather than payment of a judgment, and held that the *Switlik* decision was controlling.

The Court below recognized that the *Switlik* case was not distinguishable, but expressly stated that it disagreed with the decision of the Court of Appeals, Third Circuit (R., p. 19).

In *Seth M. Milliken* (1950), 15 T. C. 243, the Tax Court followed the decision of the Court of Appeals, Third Circuit, in the *Switlik* case, *supra*, and under similar circumstances allowed the taxpayer a deduction of the full amount which he had paid, as transferee, of a tax deficiency against his transferor corporation. On appeal, the Court of Appeals for the Second Circuit reversed the Tax Court holding that the issue is now controlled in the Second Circuit by its decision in the instant case, *Commissioner* v. *Milliken*, Fed. (2d) (C. A. 2), April 10, 1952.

The conflict between the Second and Third Circuits is leading to confusion in other litigated cases. The Tax Court cited the *Switlik* case, *supra*, in allowing the taxpayers deductions for the full amount of corporate taxes which they had paid as transferees following liquidation of the corporations, in the recent cases of *Lamar D. Fain*, 11 TCM 11, (January 10, 1952) and *Frederick M. Paist*, 10 TCM 967, (October 11, 1951). In so doing it also cited its own decisions in the *Milliken* and *Bauer* (present) cases which have now been reversed in the Second Circuit.

The Third Circuit's decision in the *Switlik* case, *supra*, has been followed in *Clifton* v. *Allen*, 101 Fed. Supp. 997, U. S. D. C., M. D. Ga., (January 10, 1952). A similar result was reached in *Eastland* v. *U. S.*, Fed. Supp. , U. S. D. C., W. D. Tex. (December 11, 1951), now on appeal C. A. 5.

2. The opinion below violates the rule of annual accounting. In holding that payment of the judgment in 1944 was an integral part of the original liquidation, the opinion effectively permits the indirect reopening of earlier years' returns and diminution of capital gain from closed transactions therein reported. This is contrary to the established rule of annual accounting, which requires each year to stand upon its own. *U. S.* v. *Lewis*, 340 U. S. 590; *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417. If allowed to stand, this opinion may well support efforts to prevent the closing of tax years in order to arrive at ultimate net results.

3. The Court below exceeded its powers of review in finding facts which were neither stipulated nor found by the Tax Court. Its opinion is founded upon its own inde-

pendent finding of fact that "considering together the events of the previous year and of the taxable year, the losses in the taxable year show up as arising out of a 'sale or exchange'" (R., p. 20).

Whether a gain or loss is from a sale or exchange is a question of fact. *Dobson* v. *Commissioner*, 320 U. S. 489. In denying a petition for rehearing (321 U. S. 231), the Supreme Court said:

> * * * "In these two cases the Tax Court held that recoveries by these taxpayers in 1939 did constitute taxable income. It held, also, that the recovery was taxable as ordinary income, despite taxpayers' contention that it should be taxed as capital gain under Section 117 of the Internal Revenue Code. This contention, the petition says, presents questions of law to be determined by this Court, rather than of fact finally to be determined by the Tax Court.
>
> The weakness of taxpayers' position lies in the fact that not every gain growing out of a transaction concerning capital assets is allowed the benefits of the capital gains tax provision. Those are limited by definition to gains from 'the sale or exchange' of capital assets. Internal Revenue Code Sec. 117 (2), (3), (4), (5).
>
> We certainly cannot say that the items in question were as matter of law proceeds of the 'sale or exchange' of a capital asset. Harwick asserted a claim, and the three other taxpayers involved in these cases filed suit, against the National City Company, demanding rescission of their purchases of stock. Their claims were compromised or admitted; the taxpayers seek to link the recoveries resulting therefrom with their prior sales of the stock, which resulted in losses. The Tax Court did not find as matter of fact, and we decline to say as matter of law, that such a transaction is a 'sale or exchange' of a capital asset in the accepted meaning of those terms."

Only a loss from the sale or exchange of a capital asset is a capital loss. This necessitates a finding of fact that the loss was from such sale or exchange. The Tax Court made no such finding of fact and the Court of Appeals should not have so found as a matter of law. The record does not support such a finding. The loss here was from payment of the judgment in an accounting suit.

The opinion below states: "that liability (we have held above) was an integral part of the original liquidation transfer". (R., p. 20) It is respectfully submitted this is a finding of fact which was not found by the Tax Court, and is contrary to the stipulated facts. It was stipulated, and the Tax Court found as a fact, that the liquidation was completed in the earlier year 1940.

4. The Court below erroneously disregarded Bauer's personal liability on the judgment, contrary to its own earlier decision.

The Court below held that "the liabilities * * * incurred under the judgment and paid, were directly related to—and would not have existed except for—the capital distributions made by the corporation to those taxpayers in earlier years." (R., p. 19) The same Court had previously held that Bauer was personally liable irrespective of capital distributions, *Trounstine* v. *Bauer, Pogue & Co., Inc.*, 144 Fed. (2d) 379 (C. A. 2), certiorari denied 323 U. S. 777. The two decisions are in conflict.

The opinion of the Court below in the present case is self-contradictory. It holds on the one hand that the liability would not have existed except for the liquidating distributions, and on the other hand recognizes Bauer's personal liability irrespective of liquidating distributions. Bauer had to pay in any event, regardless of receipt of liquidating distributions. The opinion below recognizes that such pay-

ment "would ordinarily be deductible as a straight income loss" but then denied that right because he was also a transferee (R., p. 20). The fact that he also happens to be a transferee is not a ground for denial of that deduction.

Since Bauer was liable both directly and as transferee he should be permitted to pay whichever liability gave him the greatest tax benefit (cf. *Gregory* v. *Helvering*, 293 U. S. 465, 469).

Bauer's liability as a transferee did not nullify his liability as an individual, and the Court below was in error in so holding.

WHEREFORE, your petitioners respectfully pray that writs of certiorari should be granted.

Respectfully submitted,

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